

Policy Paper No.9/2021

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Time to move to the Western Balkans: How diversification of global supply chains can benefit EU resilience

Authors: Zoran Nechev and Marie Jelenka Kirchner

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April 2021



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Acknowledgments: *The Institute for Democracy would like to thank Dr. Ivana Mateska from the Department of Management, Technology, and Economics, Swiss Federal Institute of Technology ETH Zürich for contributing with her outstanding supply chain risk expertise.*

This publication was produced by the Institute for Democracy “Societas Civilis” – Skopje (IDSCS), located in Skopje, North Macedonia, with support from the Center for International Private Enterprise (CIPE) in Washington D.C.

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Impressum

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Publisher: Center for International
Private Enterprise
Institute for Democracy "Societas
Civilis" – Skopje

Authors: Zoran Nechev
and Marie Jelenka Kirchner

Design: Dejan Kuzmanovski

This publication is available at:

<http://www.idscs.org.mk>

Introduction

Over the past decades, the topics of globalization and continuous economic growth have been in vogue. Pressured by market competition and the increasing speed of (and demand for) technological advancement, companies have shortened their product lifecycles, while at the same time producing an ever-growing number of products. To meet the demands of avid and finicky consumers, many enterprises have stationed their Research and Development (R&D) departments and innovation centers in developed countries while the manufacturing facilities have been relocated to developing countries.

This trend of globalization of multinationals has become especially evident after 2001, when China was accepted as a member of the World Trade Organization.¹ The country offered low labor costs and high production capacities. In addition to this, it represented a massive consumer base. This triggered companies not only to offshore major parts of their production to China, but also to switch to Chinese suppliers for second or third tier production.² As a result, today the global economy is heavily dependent on China. Not only does China account for nearly one-fifth of the world's production³, but for some industries, such as the automotive industry, China is the predominant

source of components. In one way or another, all manufacturing sectors are intertwined with the Chinese market. During the Covid19 pandemic in 2020-2021, the global dependency on China became obvious on many different occasions. The disruptions in China, to give one example, led to shortages in medical supplies all over the world.⁴

This paper explores how European market dependence on China manifests itself today and how this dependency stands in the way of a strategically autonomous and resilient European Union. The Covid19 pandemic is a case in point to show the depth and fragility of the interconnection. As such, it offers an opportunity to re-think global supply chains. Linking two crucial factors for EU strategic autonomy – the diversification, shortening and re-localization of global supply chains on the one hand and the thorough integration of the Western Balkans into the core of the EU on the other– this policy paper offers some observations and options for a sustainable way forward.

¹ World Trade Organisation (2020). China and the WTO: https://www.wto.org/english/thewto_e/countries_e/china_e.html Unless stated differently, this and other online resources have last been accessed in January 2021.

² Tier 1 suppliers are companies that supply parts or systems directly to original equipment manufacturers (OEMs). Tier 2 suppliers are often experts in specific domain and supply parts of components to Tier 1 suppliers. Tier 3 suppliers refer to suppliers of basic components, raw, or close-to-raw materials such as metal or plastic. They supply parts to Tier 2 suppliers, however they can also supply directly to Tier 1 or OEMs

³ Swiss Info (March 2020): Coronavirus catches managers off guard. https://www.swissinfo.ch/eng/covid-19-and-globalization_coronavirus-catches-managers-off-guard/45624906 . Accessed January 2021.

⁴ KPMG. (2020). Supply Chain and Procurement disruptions in Life Sciences sector. <http://www.france-biotech.fr/wp-content/uploads/2020/05/fr-life-sciences-supply-chain.pdf>. Accessed: 17 Dec. 2020

1. Economy over values: EU-China relations in the 21st century

Studies of democracy from the 1990s and the 2000s had championed the idea of “economic growth first, democracy second” to explain processes of democratization in Asian countries (and to predict the development of China).⁵ The case of Taiwan has been one example to prove this point.⁶ Based on this, many scholars – especially in the US tradition – argued that it was only a matter of time before China transitioned into a fully functioning democracy⁷, taking the neo-liberal path of reforming first the economy and then the political system. Those hopes have been shattered. The Chinese ruling elite does not make moves to grant more liberal rights to their people, oppresses opponents and minorities and does not care much about worker protection. Products “made in China” are quite often not associated with high quality, durability, sustainability and are known to frequently violate copyright standards.

In 2019, the European Commission published a “strategic outlook”⁸ on EU-China relations clearly

stating that “China is, simultaneously, in different policy areas, a cooperation partner with whom the EU has closely aligned objectives, a negotiating partner with whom the EU needs to find a balance of interests, an economic competitor in the pursuit of technological leadership, and a systemic rival promoting alternative models of governance”.⁹

It has become increasingly difficult to ignore the divergence between European values and the political reality in China. Recent examples of (potential) conflict encompass a variety of areas. The ongoing undermining of democratic protest in Hong Kong and the alarming disrespect for democracy and political opposition in China has been criticized by many European leaders and media outlets. Human rights organizations such as Amnesty International have published a staggering amount of evidence for the systemic oppression and exploitation of minorities such as the Uyghurs. Territorial conflicts in the South China Sea or with Taiwan keep flaring in ever smaller intervals. In Europe, the lack of respect for privacy and personal rights is watched carefully as Chinese investment in digital infrastructure (namely, 5G networks) in Europe grows. Down that same line, the telecom company Huawei, tasked with the development of 5G infrastructure, has been at the center of

⁵ See e.g. Merkel, W. (2010): Systemtransformation, VS Verlag für Sozialwissenschaften.

⁶ Roy, D. (2003). Taiwan, a political history. Cornell University Press.

⁷ The US Strategic Approach to the People’s Republic of China (2020) reflects on the misguided hope in China’s democratization (<https://china.usembassy-china.org.cn/wp-content/uploads/sites/252/U.S.-Strategic-Approach-to-The-Peoples-Republic-of-China-Report-5.24v1.pdf>). The paper by Li, He represents the (academic) sentiment in the 2000s: “Globalization and Democratic Transition in China.” American Journal of Chinese Studies 7, no. 1 (2000): 83-104. Accessed November 7, 2020. <http://www.jstor.org/stable/44288618>, while Mary E. Gallagher’s paper (2002). “Reform and Openness”: Why China’s Economic Reforms Have Delayed Democracy. World Politics, 54(3), 338-372. Retrieved November 7, 2020, from <http://www.jstor.org/stable/25054191> reveals the undemocratic ambition of the Chinese government.

⁸ European Commission <https://ec.europa.eu/info/sites/info/files/communication-eu-china-a-strategic-outlook.pdf>

⁹ Ibid.

conflict in the US, leading to sanctions against the Chinese provider.¹⁰ Despite a known lack of labour protection and union organization and widespread disregard for environmental and product standards, many European companies rely on their Chinese production sites. European norms and standards seemingly do not apply if the place of production is far enough from home – and important enough.

In 2019, 19% of EU imports originated in China, making China the biggest source of imports. At the same time, 9% of EU exports went to China, accounting to a trade volume of about 1 billion Euros a day.¹¹ Obviously, the interconnectedness of markets is not inherently wrong. But the level of dependency on Chinese imports in the EU –reflected in an EU trade deficit of €164 billion¹² - makes the EU vulnerable vis-à-vis the powerful partner, competitor, rival. This vulnerability is amplified by individualized approaches of EU member states towards China. Although the trade policy is harmonized, the EU foreign policy, driven by various, often not harmonized, approaches towards China is harming the Union to play a more significant role on a global stage.¹³ This is reflected, for example, in a disunited stance towards the Chinese Belt and Road initiative, joined by 18 EU member states mostly from Central and Eastern Europe as well as Western

Balkan candidate states.¹⁴ While Western European leaders have often criticized the engagement in this initiative, it is important to highlight that Chinese investment seems to be just as warmly welcomed in their countries. Until 2020, for example, China was among the three most important foreign investors in Germany, and the recent decline in investments is mostly attributed to increased Chinese investments at home, not to a less eager German approach.¹⁵

In an effort to harmonize relations and to find a common stance, EU-China relations were set as a key priority of the 2020 German Presidency of the European Council. The plans were overshadowed, however, by the Coronavirus: on the one hand by the outbreak of the pandemic and the resulting reservations towards the Chinese administration in Europe and the US itself; on the other hand, by the ongoing pandemic which impeded the organization of an EU-China summit in Leipzig in fall. Nonetheless, a “Comprehensive Agreement on Investment” between China and the EU was signed last-minute in December 2020 and will now need to be approved by the EU Council and the European Parliament. The agreement is said to “create a better balance in the EU-China trade relationship” by enabling more investment in China. Critics call the EU naive for believing the agreement to be, in

¹⁰ The Economist (2020). America’s war on Huawei nears its endgame. Briefing, 18 July 2020. <https://www.economist.com/briefing/2020/07/16/americas-war-on-huawei-nears-its-endgame>

¹¹ Eurostat (2021). China-EU - international trade in goods statistics. https://ec.europa.eu/eurostat/statistics-explained/index.php/China-EU_-_international_trade_in_goods_statistics#EU_and_China_in_world_trade_in_goods

¹² Ibid.

¹³ Oertel, J. (2020). The new China consensus: How Europe is growing wary of Beijing. ECFR Policy Brief. https://ecfr.eu/publication/the_new_china_consensus_how_europe_is_growing_wary_of_beijing/

¹⁴ Cornell, S.E. and Swanström, N. (2020). Compatible Interests? The EU and China’s Belt and Road Initiative. <https://isdpc.eu/publication/compatible-interests-the-eu-and-chinas-belt-and-road-initiative/>

¹⁵ Germany Trade and Invest (2020). FDI reporting 2019. <https://www.gtai.de/resource/blob/68328/7511eade7b1e609e7cc6a15f6aba27df/special-fdi-reporting-download-data.pdf>

the words of Ursula von der Leyen, “an important landmark in our relationship with China and for our values-based trade agenda”.¹⁶

Even though strong criticism towards China has been voiced more distinctively in recent years, the market connections between Europe and China remain strong. In economic terms (looking at the level of imports and exports, market connection, investments, etc.) the supposed “rivalry” seems to be pretty friendly. Here, short-term market interest trumps well too often long-term strategic interest such as sustainable economic stability, strategic autonomy, European security and human rights. The global market order prioritizes growth over ethics. The EU, struggling to present as a value-

based global actor (or, as any type of meaningful global actor, really), lacks power, instruments and its members’ will for a more radical stance.

Diplomatically, yet unmistakable, von der Leyen picked up on this dependency and lack of EU power when she asked in her 2020 State of the EU address, “But what holds us back? Why are even simple statements on EU values delayed, watered down or held hostage for other motives? When Member States say Europe is too slow, I say to them be courageous and finally move to qualified majority voting – at least on human rights and sanctions implementation.”¹⁷

For the automotive industry alone, over 80% of the supply chain is connected to China.¹⁸ This includes the manufacturing of parts in all stages of production as well as the sourcing of material. The car industry is impacted twice, because China also dominates the market on rare earth materials which are substantial to produce accumulators, among other things. The demand for rare earth elements grows even stronger with the growing E-mobility sector, as electronic cars are powered by strong batteries.¹⁹

¹⁶ The EU Commission’s press release on the CAI (December 2020) can be found here https://ec.europa.eu/commission/presscorner/detail/en/ip_20_2542, a critical report published by DGAP (January 2021) here: <https://dgap.org/en/research/publications/eu-china-comprehensive-agreement-investment-cai>

¹⁷ European Commission Press corner (2020). State of the Union Address by President von der Leyen at the European Parliament plenary, 16 September 2020. https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_20_1655

¹⁸ LMC Automotive Limited, Presentation: 20200312_Coronavirus Impact Assessment_for Amcham_vF.pdf, Page 16, 1 Point. <https://assets.kpmg/content/dam/kpmg/ar/pdf/2020/covid-19-impact-on-the-automotive-sector.pdf>

¹⁹ Menzel, S and Witsch, K (2020). Seltene Erden: Australien rüttelt an Chinas Dominanz. 20.08.2020, Handelsblatt Online. <https://www.handelsblatt.com/unternehmen/energie/elektromobilitaet-seltene-erden-australien-ruettelt-an-chinas-dominanz/26111806.html?ticket=ST-2246085-5XC69644EzeqntVo1ha-ap6>

2. The Illusion of global market stability: a dreamy bubble burst by Covid-19

The last part has shown vividly how the capitalist global market functions outside an equal and libertarian political system, and in fact even thrives without the boundaries of democracy and human rights. The illusion that capitalism in a globalized world will automatically bring democracy has lost its majority appeal. The central flaws of the neoliberal market logic have been disclosed not only by the example of China. The system's assumptions have also been challenged by their natural contrary, the US under the protectionist and anti-globalization lead of Donald Trump.

Relations between the US and China hit rock bottom during Trump's presidency. Though, not quite as bad, relations between the US and Europe also worsened. Economically (and politically), disparities between the US and Europe were growing from the moment of Trump's inauguration as US President in January 2017. When his administration's introduction of tariffs and trade barriers in 2018 started an ongoing "trade war" between the US and China, the EU was left sitting on the fence. Despite not being an active participant in this conflict, European economies

have suffered negative effects. Those impacts are mostly bound to a more fragile and more hostile global economic environment and a cut in global growth rates.²⁰ This, in return, is directly linked to the weakened position of the World Trade Organization on whose moderation the EU highly depends. From the very beginning, the WTO had criticized the new tariffs as unlawful, angering Trump.²¹ Contrary to what had been expected though, the EU has not been paralyzed in the conflict. Instead, new structures were developed by the European Commission to ensure smooth sailing independent of the US direction.²²

This shows clearly that conditions were already unfavourable when the global pandemic and its national shutdowns, border closures, travel bans, and mobility restrictions hit. Levels of trust between market leaders were shaky. The belief in the flawless functioning of the globalized economy has crumbled notably ever since. The EU, under new guidance from von der Leyen and her geopolitically oriented Commission, continued the struggle to get a foothold as a meaningful global actor.²³

When the Coronavirus started spreading through the world, the level of distrust towards the undemocratic one-party rule of the Chinese Communist Party hit a new low. This was expressed in stereotypical and racist scapegoating of the Chinese people and nation by media and politicians, spilling over

²⁰ Basedow, R. (2019). The US-China trade war. Risks and opportunities for the EU and the United Kingdom. LSE Blog. <https://blogs.lse.ac.uk/europpblog/2019/10/17/the-us-china-trade-war-risks-and-opportunities-for-the-eu-and-the-united-kingdom/>

²¹ Deutsche Welle (2020). WTO rügt Trumps Strafzölle gegen China. <https://www.dw.com/de/wto-r%C3%BCgt-trumps-strafz%C3%B6lle-gegen-china/a-54938957>

²² European Commission (2020). Multi-Party Interim Appeal Arbitration arrangement pursuant to article 25 of the DSU. https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158685.pdf

²³ Kirchner, M. J. and Nechev, Z. (2020). Global change starts at the doorstep: Why the Western Balkans matter for Ursula von der Leyen's geopolitical Commission. Published through Institute for Democracy Societas Civilis Skopje and Konrad Adenauer Stiftung Skopje Office. <https://www.kas.de/documents/281657/281706/UvdL+Publikation%28ENG%29.pdf/8a892a12-078b-2b82-5f45-087e60991e93?version=1.0&t=1593198674269>

to Western societies.²⁴ Though the European political establishment was more cautious than the US-leadership in their critique of the Chinese handling of the early crisis, nonetheless one could observe a shift in narrative towards cooperation with China. Dependence on the Chinese production of pharmaceuticals in particular had the alarm bells ringing in European capitals and Brussels. As soon as the Chinese economy reacted to the spread of the disease, experts in Europe were alarmed by quickly emptying pharmaceutical storage of several essential medications, because production at the main pharmaceutical plants in the Chinese regions Wuhan and Hubei were temporarily halted. According to a Deloitte study, over 200 of the Fortune Global 500 companies have a presence directly in Wuhan.²⁵ The pharmaceutical sector was the first for which Europeans discussed, and vaguely decided on, more diversified supply chains for more resilience at home.²⁶ But the lock-down in China disrupted supply-chains in other sectors as well, both in manufacturing (automotive, steel etc.) and high-tech industries bringing delivery shortage for many companies.²⁷

The Covid-19 pandemic has turned everything upside down, and much of it seems to be for the worse. The global economy has not been cushioned for such an extreme punch and according to World Bank insights, the global economy shrunk by 4.3 percent in 2020²⁸, representing the deepest recession since the Second World War. While the outlook for 2021 is slightly better, much of it seems to fall onto China which, having rigorously pushed through restrictions in the first half of 2020 unlike European economies, registers positive economic growth in 2020.²⁹

The recession, paired with the ongoing uncertainty, social isolation, and unclear national strategies to combat the pandemic, brings not only revenues and profits to fall in seemingly bottomless holes. It also shatters trust in the global economic system which, as has been explained before, was not so rosy to begin with. Economic activity is expected to contract in every sub-region in 2020 as outbreaks of the virus constrain private consumption and investment: Central Europe by 5%, Western Balkans by 3.2%, and Eastern Europe by 3.6%.³⁰

²⁴ The national geographic analyses this phenomenon in a wider (American) racist fashion (02.09.2020): <https://www.nationalgeographic.com/history/2020/09/asian-american-racism-covid/>, several studies have by now analysed persisting patterns of Anti-Asian narratives in the US and Europe as presented by EurActiv (09.07.2020): <https://www.euractiv.com/section/non-discrimination/interview/corona-related-racism-could-persist-longer-than-the-virus-expert-warns/> while German news outlets were fearing a "new cold war" between China and the US in spring 2020 as a result of an antagonistic discourse in Washington (30.05.2020: <https://www.dw.com/de/corona-befeuert-chinesisch-amerikanischen-weltkonflikt/a-53613192>)

²⁵ Deloitte (2020). COVID-19 - Managing supply chain risk and disruption. <https://www2.deloitte.com/global/en/pages/risk/cyber-strategic-risk/articles/covid-19-managing-supply-chain-risk-and-disruption.html>. Accessed: 17 Oct. 2020

²⁶ European Commission (2021). EU4Health 2021-2027 – a vision for a healthier European Union. https://ec.europa.eu/health/funding/eu4health_en

²⁷ Deloitte (2020). COVID-19 - Managing supply chain risk and disruption. https://www2.deloitte.com/content/dam/Deloitte/ca/Documents/finance/Supply-Chain_POV_EN_FINAL-AODA.pdf. Accessed: 17 Oct. 2020

²⁸ World Bank Flagship Report (January 2021): Global Economic Prospects. <https://www.worldbank.org/en/publication/global-economic-prospects>

²⁹ SWP (2020): China – Pandemiegegner für den Moment. <https://www.swp-berlin.org/10.18449/2020A99/>

³⁰ World Bank (2020): Global Economic Prospects Report. <http://pubdocs.worldbank.org/en/344691588788182868/Global-Economic-Prospects-June-2020-Regional-Overview-ECA.pdf>

The Covid19-crisis has revealed a variety of political and economic flaws of the current global, and European, system. As a way forward, European leaders have therefore discussed possible scenarios towards more resilience and autonomy of the EU, both politically and economically. With this paper

we wish to contribute to the debate by linking two challenges of today (the market dependency on China and the European integration of the Western Balkans) for a resilient, strategically autonomous European Union of tomorrow.

COVID-19 AND THE AUTOMOTIVE SUPPLY CHAINS

With an annual turnover of 1.9 trillion euros and direct global employment of 14 million workers³¹, the automotive industry is among the most significant contributors to the world's economy. Similar to many other industries, the supply chains of automakers are designed to utilize low-cost workforce in developing countries and have their final product assembly in developed countries (or close to the end customer). However, contrary to others, it is not an industry that can operate remotely, i.e., the majority of employees is composed of shop floor workers.

Wuhan, the city where the outbreak started, also recognized as the “motor city”, is the home to many plants producing parts for General Motors, Honda Motor, Nissan Motor, Renault and Toyota Motor and others. When the initial Covid-19 crisis started, the production in these factories was stopped, causing supply shortages for the original equipment manufacturers (OEM). As the virus spread to Europe and USA, a raft of temporary closures followed in the western world. In Europe alone, the average shutdown duration was 30 working days.³² As a result, the production losses for the first 3 quarters in 2020 are estimated to be over 4 million vehicles, which is 22.3% less compared to the same period in 2019.³³ As Michael Manley, President of the European Automobile Manufacturers' Association (ACEA) and CEO of Fiat Chrysler Automobiles states: “The COVID pandemic is the biggest single risk ever to face our industry”.³⁴

³¹ ILO (2020). ILO Sectoral Brief: Covid-19 and the automotive industry. Briefing note, 07 May 2020.

³² ACEA (2020). Interactive map: Production impact of COVID-19 on the European auto industry. European Automobile Manufacturers Association, 1 June 2020. <https://www.acea.be/news/article/interactive-map-production-impact-of-covid-19-on-the-european-auto-industry>. Accessed: 10 Nov. 2020.

³³ ACEA (2020). Interactive map: COVID-19 impact on EU automobile production, up until September 2020, European Automobile Manufacturers Association, 20 Oct. 2020. <https://www.acea.be/news/article/interactive-map-covid-19-impact-on-eu-automobile-production-up-until-septem>. Accessed 10 Nov. 2020

³⁴ ACEA (2020). Video - “COVID pandemic: biggest risk ever to face EU auto industry,” warns Michael Manley. European Automobile Manufacturers Association, 20 Oct. 2020. <https://www.acea.be/news/article/video-covid-pandemic-biggest-risk-ever-to-face-eu-auto-industry-warns-micha>. Accessed: 11 Nov. 2020.

Indeed, the Covid-19 crisis revealed the weaknesses of the automotive supply chains as an example of globalized manufacturing heavily dependent on sourcing from a geographical region affected by a disruption. With most of the global automakers are obtaining 30 to 60 % of their purchasing volume from China³⁵, a negative effect on this sector was inevitable.

This raises the question: Will the automotive industry respond to this crisis “by the book”? The complexity of the products in terms of variety of materials and huge number of modules and sub-modules, makes regionalization and localization of the automotive supply chain a complex challenge. Yet, OEMs are starting to rethink their supply chains. The benefits of diversifying the supply base and shortening supply chains are considerable especially in the long run, as they not only promote greater security and increase resilience, but can also help companies cope better with the ongoing trade wars, political instabilities, and pressures for sustainability performance.

The Western Balkans could be an ideal region to relocate some production parts considering the region’s well-developed automotive industry base. Having in mind the focus on green and circular economy in the EU³⁶ as well as the Western Balkans³⁷, it would be extremely useful to strategically position the Western Balkans as the key supplier to hybrid, electrical and autonomous vehicle producers in the near future. Instead of focusing on relocating existing industries – which may be a daunting task – the European car producers should forge a strategic alliance aimed towards fulfilling the future needs proactively.

³⁵ Piparsania (2020). COVID-19 impact on global auto industry: need for more resilient supply chains. Auto Tech Review, 28. July 2020. <https://autotechreview.com/opinion/guest-commentary/auto-industry-covid-19-supply-chain-disruption-resilient-india-auto-industry-china-auto-industry-global-auto-industry>. Accessed: 11 Nov. 2020.

³⁶ Despite the European Green Deal and the Corporate Social Responsibility initiatives, several European countries have proposed initiatives for legal extension of companies’ corporate and social responsibility across their supply chain members. In other words, companies that cause or accept damage to people and the environment in their supply chains must be held legally liable. Examples of such initiatives are the Supply Chain Initiative Act (Lieferkettengesetz) in Germany (<https://lieferkettengesetz.de/>) and the Corporate Responsibility Initiative (Konzernverantwortungsinitiative) in Switzerland (<https://konzern-initiative.ch/?lang=en>)

³⁷ European Commission (2020). Guidelines for the Implementation of the Green Agenda for the Western Balkans. European Commission, 6 Oct. 2020. https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/green_agenda_for_the_western_balkans_en.pdf Accessed: 7 Dec. 2020

3. The European Way forward: Value-driven resilience

When talking about economic dependencies, globalization per se is not the main problem and as such it is not in the European interest to turn to protectionist rhetoric and action. Nonetheless, the current economic model – which relies heavily on outsourcing to less developed, often authoritarian-led countries far away – is unsustainable, unethical, and as such conflicts with the EU's self-understanding. A side-to-side check of von der Leyen's geopolitical vision for the EU and the economic and political reality in China illustrates the obvious disparities. That said, it would be inappropriate to merely point fingers at the Chinese administration. The Chinese economic system of exploitation and wage dumping enables the capitalist order upon which Western governments and corporations rely, and which they support actively or indirectly. Therefore, the way out is for the EU to stick to its ambitions and to show alternatives in practice.

In the EU recovery plan, resilience plays an important role. This resilience requires the EU to become less dependent on other global players and instead become more autonomous in its decisions and reactions to international crises.

a. Political instruments for institutional change

There is no single, perfect way towards more resilience. Instead, different political and economic instruments must be combined. In this paper, we offer a variety of policy areas and instruments to be applied and, ideally, combined.

First of all, we begin from the presumption that the heterogeneity of EU member states interests is, while tempting in theory, a major hindrance in practice. History has shown that “united in diversity” is wonderful when it comes to cultures and societies, yet often impractical for intergovernmental decision-making in foreign policy.

In order not to be internationally marginalized, the EU needs to stick to its commitment and use the potential of its modern, supranational structure to present a different, more normative and more inclusive approach. This would demand some serious restructuring in the institutional design of the EU and a transfer of competencies from the national level to the EU. The geopolitical Commission has laid out the grounds for a reform-friendly mindset in Brussels, supported by a few visionary leaders throughout Europe. While the goal of institutional restructuring, and especially a change towards Qualified Majority Voting in foreign policy, is not completely out of reach, it seems nonetheless idealistic to hope for rapid development in this area.

On the other hand, economic instruments might be more feasible – and more convincing – for EU leaders at this very moment. In our paper we focus on the re-thinking and re-structuring of global supply chains, by means of increased diversification and localization. The easiest way out of complete dependency on China would be, in our opinion, investment in the Western Balkan region. That way, parts of production and storage facilities could resettle from China to the immediate proximity of EU external borders. The last part of this paper will reveal the manifold opportunities in this approach.

b. Economic instruments: Re-thinking Supply Chains

The economic interruptions caused by the Covid-19 crisis have exposed many vulnerabilities of the European supply chain design and raised doubts about current risk practices from a predominantly strategic perspective. Globalized supply chains, single-sourcing strategies, and dependence on sourcing from specific, remote geographical regions such as China have made it difficult for European companies, and consequently governments, to respond to a market disruption with the magnitude of this pandemic.

The general consensus among supply chain risk professionals and academics holds that the resilience of supply chains on the one hand, and the competitiveness of their business – including cost efficiency – is the core interest of corporations.³⁸ Past habits have shown that the concern of

competitiveness and production costs have outweighed concerns for resilience. At the same time, sustainable or ethical practices have been systematically sidelined. While the pandemic has proven that resilience and risk-management go hand-in-hand in the economic interest of companies, sustainability, ethics and political resilience remain to be political, as opposed to economic, interests. For a step forward it must be the EU's task to use the economic instruments at hand – taxation, import regulation, subsidies etc. – to incentivize the transparent and diversified re-organization of European supply chains.

To prepare the European economy, as well as companies on a micro level, **scenario planning** is important. Companies often have a rather reactive risk management approach³⁹, but so has the EU. This entails coping with risks on an ad hoc basis as they arise, for example by developing a temporary workforce only when a threat to their existing workforce appears. Certainly not every crisis can be predicted, but many can be, at least in part. A reactive strategy is costly, both in terms of money and time. Competitors with well-rehearsed mitigation strategies can respond faster and more efficiently. As the frequency and severity of disruptions intensified over the recent years (i.e., the global financial crisis, Brexit, US-China trade conflict, the COVID-19 crisis), companies have faced rather unexpected but severe supply and demand interruptions. These disruptions have demonstrated that large variances cannot be managed through statistical and algorithmic models

³⁸ For an academic analysis see for example Jamal El Baz and Salomé Ruel (2020): Can supply chain risk management practices mitigate the disruption impacts on supply chains' resilience and robustness? Evidence from an empirical survey in a COVID-19 outbreak era. Published online in International Journal of Production Economics <https://doi.org/10.1016/j.ijpe.2020.107972>

³⁹ Kutsch, E. and M. Hall (2010). "Deliberate ignorance in project risk management." International Journal of Project Management 28(3): 245-255. <https://www.sciencedirect.com/science/article/pii/S0263786309000520>

where unusual events are disregarded as “outliers” and overlooked in operational programming. As the still-unfolding process of the Covid-19 economic crisis is uncertain, scenario planning techniques must become an essential part of strategic risk management.⁴⁰ Developing several scenarios with concrete actions would allow companies to have a more prepared response and easily navigate between alternatives.⁴¹ Ongoing flows of migration, the consequences of climate change or market instability are just few areas which have future crises in store. A resolute and systemic rethinking at the macro- and micro level is vital to the resilience and strength of European companies, governments and the EU.

A new approach to *inventory policy* can only be the first step. At the time being, low inventory levels and just-in-time manufacturing across the different elements of supply chains are an important cost-cutting mechanism. This means that only a small safety stock – based on historical data – is available to satisfy expected demand and supply fluctuations. For example, Microsoft’s Windows and Surface businesses expect lower earnings than anticipated in the third quarter of 2020, as both depend on hardware shipped from China.⁴² Similarly, insufficient stock of protective face masks quickly became an issue during the pandemic. Companies who could no longer supply on the one hand and governments, societies, and medical care providers were faced

with a lack of protection and preparedness during the health crisis.⁴³ Therefore, companies need to rethink their inventory policy. Inventory should be stored in strategic locations from where it could be easily accessible to the downstream entity. This is important not only for delivering final products to customers, but also for components which are heavily dependent on one market.

This whole paper looks predominantly for European companies to go beyond Chinese, or China-based, suppliers. In the strategic planning, the aspect of *supplier selection* comes in play. Traditionally, cost, quality, delivery time and, for some industries, innovation have been the main selection criteria for suppliers. The experience of the current crisis might encourage companies to evaluate their supplier’s reliability and risk management. The mentioned criteria remain important, but so are aspects of sustainability, ethics, and political resilience of the wider system.⁴⁴ Neither of these aspects is especially economic in a traditional sense, focused on the annual balance. They are, however, of fundamental importance for the future of the EU and Europeans. Numbers-oriented companies have proven to disregard the implications of exploitive structures in production countries, because the cheaper they can produce, the greater their profits. Here, the EU needs to incentivize and subsidize companies into alignment with European values. This, of course, is easier if supply chains do not go

⁴⁰ The Economist (2020). The great unwinding: Covid-19 and the regionalization of global supply chains.

⁴¹ Körner (2020). Scenario planning: the path to a ‘new normal’. <https://www.tacook.com/en/content/blog/scenario-planning-the-path-to-a-new-normal/>. Accessed: 16 Sept. 2020

⁴² Microsoft (2020). Microsoft update on Q3 FY20 guidance.26. Feb.2020. <https://news.microsoft.com/2020/02/26/microsoft-update-on-q3-fy20-guidance/>. Accessed: 25 Nov. 2020.

⁴³ WHO website (March 2020): Shortage of personal protective equipment endangering health workers worldwide: <https://www.who.int/news/item/03-03-2020-shortage-of-personal-protective-equipment-endangering-health-workers-worldwide>

⁴⁴ See for example: Hosseini, S. and K. Barker (2016). “A Bayesian network model for resilience-based supplier selection.” International Journal of Production Economics 180: 68-87. <https://www.sciencedirect.com/science/article/pii/S0925527316301530>

all around the globe, but if instead production sites are located in closer proximity in a sphere of EU political influence such as the Western Balkans.

Re-organization of supply chains will be initially costly, as is any investment into innovation. As a first step, companies should rely more heavily on multi-sourcing. Multi-sourcing is one of the most efficient supplier risk management practices, as it ensures that the production will not stop if the flow from one supplier is disrupted.⁴⁵ Of course, this increases the complexity of the supply chains, and it comes at a cost, as it requires greater cooperation for harnessing the maximum benefits. Complexity – if paired with transparency – however, significantly increases resilience both in terms of crisis management as well as malpractice. Consequently, Jörg Wuttke, president of the EU Chamber of commerce in China, sees a main lesson for companies in the pandemic: “single sourcing is out, diversification is in”.⁴⁶

Furthermore, it has become evident from this pandemic that having alternative suppliers is not the only requirement for a successful multi-sourcing approach. If they are all based in the same region, the vulnerability remains. Therefore, suppliers must be located in different geographical regions. This is when **localization** enters the scene. By definition, localization entails reorienting supply chains towards suppliers in specific countries and regions in close proximity to the final customer, such as a

reorientation of suppliers to the Western Balkans for close proximity to the EU. Although localized sourcing might increase the manufacturing costs, it offers multiple material benefits in other areas. For example, it reduces the complexity of the supply chains, it minimizes lead times, decreases or eliminates tariff costs and reduces the risks for cross-border delays. Furthermore, it offers many different opportunities for the EU to fulfil political goals for the Western Balkans on their European path.

Even if the re-organization of supply chains to diversify supply sources in closer geographic proximity might be costly initially, it will pay off on the long run for companies and the EU alike. Besides, this step will make the EU less dependent on authoritarian China. A new approach to global economy and a concentration of more essential production closer to home will be essential to the EU's global strength. Only if less dependent on an unequal and unpredictable partner like China can the EU develop the strategic autonomy it will need in order to remain (or truly become) a meaningful global actor. When speaking about global strength and resilience, the EU should therefore not look far. Instead, political will is needed to systematically tackle European industry. Non-exploitive production close to Europe must become more attractive than to rely on supply from less developed or developing areas with problematic industrial realities.

⁴⁵ Mandal, S. (2014). “Supply chain resilience: a state-of-the-art review and research directions.” *International Journal of Disaster Resilience in the Built Environment* 5(4): 427-453.

⁴⁶ ECCT (2020). Dealing with the coronavirus in China. European Chamber of Commerce Taiwan. 3 Mar. 2020. <https://www.ecct.com.tw/dealing-with-the-coronavirus-in-china/>

4. Why longing for the distance? The Western Balkans as key European region of opportunity

By moving production to the Western Balkan countries, all of them current or future member states of the EU, one can hit two birds with one stone: first, less dependency on the critical rivals on the world political and economic stage; and second, increasing incentives to democratize and strengthen the Western Balkans, thus enabling regional integrity in Europe. This moment should be seized as an eye-opening chance for European leaders. Looking at the map of Europe, a relocation of a portion of production to the Western Balkans makes sense for many reasons – beyond strategic or moral considerations.

The Western Balkans are physically close to the EU. This proximity allows for easier inspection to guarantee compliance with European norms and standards. It also decreases the distance for shipments of final products or parts. The carbon footprint of globalized supply chains is immense and the trade practices of European economies are at odds with EU's ambitious climate plans. Shorter distances for products to travel (on land) will help the EU meet its climate targets.

As future members of the EU, the Western Balkans are at different stages of their EU integration. Much of this integration is measurable in economic terms and creates a favorable environment for investment, trade and the re-localization of production sites.

Introduced first through the instrument of Stability and Association Agreements (SAA) the Western Balkan countries have been invited by the EU into a free-trade area to eliminate “duties and non-tariff restrictions on bilateral trade”⁴⁷ as well as ensuring production standards, protection of property and the like according to EU norms.

Central European Free Trade Agreement (CEFTA) from 2006 further paved the way for liberalization of trade in services, investment, public procurement, intellectual property rights. Its implementation widely opened the door of applying diagonal cumulation of origin of goods (in trade between the countries of the region and the region with the EU).⁴⁸

Parallel to the agreements in the context of EU enlargement, the Western Balkans have joined the Pan-Euro-Mediterranean (PEM) Convention, a system which was established in 2013 and modernized in 2020 to allow for full cumulation of origin between several EU partner countries. This harmonizes production and supply chains between EU and its partnering states such as the EFTA states or the Western Balkans, because products or parts originating in one country are treated as if produced

⁴⁷ European Commission Website (2020). Trade Policy Infographic. <https://ec.europa.eu/trade/policy/countries-and-regions/regions/western-balkans/>

⁴⁸ Central European Free Trade Agreement Website (2021) Legal Documents. <https://cefta.int/legal-documents/>

or manufactured in any other of the participating states.⁴⁹

The Western Balkans are a tariff-free region with zero percent customs duties for goods generated and traded within the region. This liberal intra-regional trade regime enables smooth supply chains within the region. During the 2020 Sofia Summit, the commitment to the Common Regional Market has been endorsed by all participating leaders to prepare the countries for entering the EU Single Market. In a nutshell, this initiative resembles the conditions of the Single Market – free movement of goods, services, capital and people – in addition to expanding the EU digital area with the Western Balkans, investments, research and development and the Green Agenda – to better integrate the Western Balkans already now and to increase the efficiency and attractiveness of the region for investment and production to better integrate the Western Balkans already now and to increase the efficiency and attractiveness of the region for investment and production.⁵⁰

This goes hand in hand with the aim to achieve regional standards for Foreign Direct Investment (FDI). Harmonized regional standards which would allow for clustered production in the automotive industry, for example, reflect the need to shift from traditional linear supply chains to a more innovative and branched approach. Through clusters and networks (among the region) various forms of collaboration, responsiveness and product standards can be enhanced, benefitting not only the region, but

equally investors and manufacturers from abroad.

When speaking about foreign investments, the different strings of argumentation from this paper are leading to a common point. As we argued in the beginning, the EU should become more economically independent from China and should therefore incentivize manufacturers to relocate production to the Western Balkans. At the same time, the EU should also seize more political independence in order to grow to a global power based on a normative, ethical approach to foreign policy. This independence also entails a united stance of current and future member states towards China. Recent patterns of Chinese investment in Western Balkans countries should send warning signals to EU leaders. With investments in critical infrastructure throughout the region, the Chinese governments offer Western Balkan leaders a seemingly comfortable alternative to conditioned EU investment. At the same time, Western Balkan countries become financially dependent – for years to come – on the big power, which could undermine the EU in the future. In the Western Balkans, China must be regarded a strong competitor and rival to the EU. It is therefore inevitable for the EU to mark its territory – non-coercively – with the tool she is best known for: economic persuasion.

That said, we do not aim to paint a distorted, rose-tinted picture of the current capacities in the Western Balkans. A lot of the potential for the EU and EU manufacturers is yet to be unearthed. While the economic conditions for trade with and investment

⁴⁹ European Commission Website (2020). New Rules of origin for Pan-Euro-Mediterranean countries. <https://www.wb6cif.eu/2020/08/25/new-rules-of-origin-for-pan-euro-mediterranean-pem-countries/>

⁵⁰ European Commission Website (2020): European Neighbourhood Policy and Enlargement Negotiations: Common Regional Market. https://ec.europa.eu/neighbourhood-enlargement/policy/common-regional-market_en

or production in the Western Balkans are favourable as presented above, the general, technical infrastructure is yet to be built, including routes of transportation, industrial complexes, or digital infrastructure. The great opportunity is here to invest in the latest technologies and built digitalized structure from the beginning. New technologies and digitalization have undoubtedly proven in the past to be an enabler for more efficient, more transparent and more effective supply chains. In one of its latest reports, DHL outlined the expected technological trends in logistics within the next few years.⁵¹ Expectedly, the importance and the necessity for advancing existing technologies and developing new digitalized solutions for supply chains has intensified during the recent Covid-19 crisis. For example, developers of augmented reality and virtual reality have reported that the demand for tailored solutions tripled since the crisis started. Furthermore, with the current social distancing in place, automation, robotization, and 3D printing become even more necessary, not only because it goes in hand with social distancing measures, but it enables localization. While a relocation to the Western Balkans therefore definitely demands courageous investments from the side of the EU and – incentivized – EU manufacturers, it also offers an opportunity to create a modern and innovative environment that is hard to implement in established industrial structures. The Baltic States, especially Estonia, offer a great blueprint to observe how modern and digital approaches of once underdeveloped European states can bring out future-oriented governance and industries. The same is

true for environmentally friendly and sustainable industry, energy production and industrial practice. In the Western Balkans, the EU has the unique chance to invest in the infrastructure and technology of tomorrow, almost from scratch. This will not only have measurable impact on the carbon footprint of Europe as a continent but will also help champion the ambitious EU Green Deal.

But not only in the field of sustainability can the EU work on its strategic agenda in the Western Balkans. The international political standing of the EU is poor and its value-based agenda – sadly – a façade. This is owed not to the political reality of our world; innovative and justice-oriented approaches are possible, however not under the pretexts of the current system. In the Western Balkans, the EU would have the opportunity to prove that it is committed to egalitarian global structures and an economy which does not thrive on the exploitation of labour force and resources overseas.

An investment into the region, hard hit by the social, political and economic consequences of the Covid-19-pandemic, can win favours easily. At the same time, the investment in democracy, society, infrastructure and digitalization in the Western Balkan is an investment in the shared, hopefully strongly independent, European future.

⁵¹ DHL (2020). The Logistics Trend Radar - 5th Edition. DHL Customer Solutions & Innovation. <https://www.dhl.com/discover/business/market-intelligence/logistics-trend-radar>

Conclusion

From an analytical point of view, it is increasingly difficult to ignore the difference between the (envisioned) European and the (real) Chinese modus operandi. The EU's self-perception, or its communicated desire, of being a value-based global power is negated by the dependence on the Chinese market and hence the Chinese government. European leaders keep reaffirming their geopolitical ambitions in narrative, while the economic and political reality remains focused on "business as usual" and continues the fetishization of economic growth at all costs. Trapped in the prevailing belief in the power of liberal economy driving democratic transformation, European actors are seemingly in denial of the geopolitical reality. For the time being, China is the clear winner.

But the game is not lost, if only the EU begins to rely more on strategic thinking, as China has done. Obviously, it is easier to strategically plan-ahead for years to come in an authoritarian one-party system than it is in a supranational (wannabe) democracy. Nonetheless, if the EU wants to remain relevant on the international stage, strategic planning must become the operating principle. Using the EU's main area of competence – economy – this brief has shown a way into the right direction.

The secret of success is, at least in parts, to be found in the way supply chains are being (re-) structured. Localization, hence re-orientation of supply chains into near proximity of the EU, and a diversification of suppliers are first and important steps towards economic independence and consequently political strength and resilience.

By incentivizing, the localization of companies in the Western Balkans, perhaps through ambitious subsidies, the EU has the unique opportunity to connect two areas of policy – economic independence and EU enlargement – which are crucial to its de facto influence in global affairs. At the same time, the investment into sustainable, democratic, and innovative structures in the Western Balkans has a long-term positive effect for the EU. Not only does this offer an opportunity to manifest the value-based approach to foreign policy. In the long run, the Western Balkan countries desire EU membership. EU (conditioned) investment in the Western Balkans is therefore an investment in the shared, value-oriented future of Europe as a whole.

Information about CIPE

Free market capitalism and global trade have resulted in the greatest economic gains in human history, yet gaps remain and some are being left behind. This is the result of unequal economic opportunity, a lack of universal entrepreneurial and economic opportunities, and an inability for people to connect to global value chains. CIPE's programs work to address these problems. CIPE was founded on the principle that economic freedom and political freedom are linked. A strong private sector needs a flourishing democracy to work – and vice-versa. Our work centers on building strong democratic institutions to create an enabling environment for business and entrepreneurship to flourish. Whether that be leading anti-corruption efforts, training entrepreneurs, helping local business associations, chambers of commerce, and think tanks, assisting in presidential debates focusing on the economy, or building good governance structures – we are there on the front lines battling to strengthen and support democracy and its institutions so the private sector can thrive.

Contact information about CIPE

Washington, DC
1211 Connecticut Avenue, NW, Suite 700
Washington, DC 20036
Tel: +1 202 721 9200
Fax: +1 202 280 1000

Information about IDSCS

IDSCS is a think-tank organisation researching the development of good governance, rule of law and North Macedonia's European integration. IDSCS has the mission to support citizens' involvement in the decision-making process and strengthen the participatory political culture. By strengthening liberal values, IDSCS contributes towards coexistence of diversities.

Contact information about IDSCS

Address: Str. Miroslav Krleža 52/2, 1000 Skopje
Phone number/ Fax: +389 2 3094 760
E-Mail: contact@idscs.org.mk

Information about the authors

Zoran Nechev is a senior researcher and head of the Centre for European Integrations within IDSCS. His fields of academic and professional interest are EU enlargement, Europeanisation, external actors and malign influence, policy of conditionality, Western Balkans, justice and home affairs.

Marie Jelenka Kirchner is an associate researcher of the Centre for European Integrations within IDSCS. Kirchner is a PhD candidate at the University of Graz who obtained an MA degree in Central and Eastern European Studies from the Jagiellonian University Krakow. She is founder of the European Thinkers' Lab. Her research focus lies on Europeanization and European foreign policy, especially in regards to EU enlargement

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Policy Paper No.9/2021

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**Time to move to the Western Balkans:
How diversification of global supply
chains can benefit EU resilience**

Authors: Zoran Nechev and
Marie Jelenka Kirchner

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April 2021